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Supreme Court of the United States

OCTOBER TERM, 1943.

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No. 490.
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TRICO PRODUCTS CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**PETITION FOR REHEARING OF PETITION FOR A WRIT
OF CERTIORARI TO THE CIRCUIT COURT OF
APPEALS FOR THE SECOND CIRCUIT.**

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY,
Counsel for Petitioner.



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PETITION FOR REHEARING.

*To the Honorable the Chief Justice of the United States
and the Associate Justices of the Supreme Court of the
United States:*

A rehearing is respectfully requested of petitioner's application for a writ of certiorari to review a judgment of the Circuit Court of Appeals for the Second Circuit, which this Court denied on December 20, 1943.

Rehearing is requested because the case involves a clear-cut question of law as to the proper construction of Section 102 of the Revenue Act of 1934 (48 Stat. 702). The question of statutory construction involved is an important one in the administration of the revenue acts, which should be passed on by this Court. We respectfully submit that the Court did not intend by its decision in the case of *Dobson v. Commissioner of Internal Revenue* (December 20, 1943)

to foreclose consideration by this Court of important questions of statutory construction of this type.

The judgment of the Circuit Court of Appeals for the Second Circuit affirmed a decision of the Tax Court finding a deficiency in petitioner's corporate surtaxes for the years 1934 and 1935 in the aggregate amount of \$1,617,931.89. Under the statute such surtaxes can be imposed only where the corporation is found to have been

“formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting gains and profits to accumulate instead of being divided or distributed
• • •”

As shown by its opinion, the Tax Court sustained the Commissioner on that essential point on the basis of a construction of the statute which the petitioner contends to be erroneous.

The questions of law involved were stated as follows in the Government's brief in opposition to the petition for a writ of certiorari (p. 2):

“QUESTIONS PRESENTED

* * * *

“2. Whether the Board of Tax Appeals erred (a) by failing to make an express finding that the purpose of avoiding surtaxes was a *substantial* factor inducing the taxpayer's accumulation of earnings, or (b) by misapplying the presumption established by subdivision (b) of Section 102 of the Revenue Act of 1934.” (Italics ours.)

These questions are of great practical importance to active business corporations in conducting their affairs with reference to war and post-war conditions.

This Court should review and reverse the lower Courts' construction of the statute as authorizing the imposition of corporate surtax liability in the absence of a finding that the purpose of preventing the imposition of individual surtaxes on shareholders was a substantial factor in inducing accumulations by the corporation.

The Government stated in its brief in opposition to the petition for a writ of certiorari that "the Board's finding that the taxpayer was availed of for the condemned purpose (R. 73) *would seem* to carry with it a determination that the avoidance of surtaxes was a substantial factor inducing the accumulation of profits" (p. 14—italics ours). This is a virtual admission that the statute requires such a determination. The actual opinion of the Tax Court, however, shows that its finding of the condemned purpose was *not* predicated on a determination that tax considerations had been a *substantial* factor in inducing the accumulation. Thus the Tax Court stated that the petitioner's evidence must be directed to the establishment of "the complete lack of the condemned purpose * * * and if it does not fairly prove an absence of such purpose, it must fail regardless of what other purposes it may prove" (R. 89); that a demonstration by petitioner of "the complete innocence" of its purpose is required (R. 89); and that petitioner is subject to the tax unless the Court is convinced that the stockholders "never * * * allowed their purposes to stray" to tax savings (R. 95) and that there had been "no taint of a purpose" to avoid surtaxes (R. 98).

It is apparent that the Tax Court did not find, or purport to find, that the prevention of surtaxes was a substantial factor in inducing the accumulations in question. On the contrary, it misconstrued the statute as imposing the tax unless this factor was wholly absent.

The decision below on this point directly conflicts in principle with the decision of this Court in *United States v. Wells*, 283 U. S. 102 (1931), construing a statute imposing taxes on transfers made "in contemplation of death." The Court there held that "the words 'in contemplation of death' mean that the thought of death is the impelling cause of the transfer," and that liability attaches only where the contemplation of death was "a controlling motive" or "inducing cause."

Nothing in the opinion of this Court in the *Dobson* case indicates any reason for denial of review in this case. Any general desirability of not disturbing decisions of the Tax Court must of course yield to the necessity for correcting such decisions if inconsistent with controlling principles laid down by this Court. Presumption that the determination of the Tax Court should stand because involving complex questions relating to a highly specialized subject has no application where, as here, the question of law is simple. The question is simply whether (a) as the Tax Court thought, the corporation must prove a complete lack and absence of any taint of the condemned purpose, or (b) as petitioner contends, the condemned purpose must be at least a substantial cause in inducing the accumulation. The Circuit Court of Appeals did not deal with this problem, but simply stated that it could not "subscribe to the view that the prevention of the imposition of surtaxes must be shown to have been the *dominant* factor behind the accumulations" (R. 374-5). It overlooked the fact that the Tax Court had failed to find that the prevention of the imposition of surtaxes had been even a *substantial* factor behind the accumulations.

Under the Tax Court's construction of the statute, a **taint of the condemned purpose** can always be imputed to

the controlling stockholders. In every case there will have been accumulations which, if distributed, would have increased the surtaxes currently payable by the stockholders. The corporation is thus deprived on this construction of the right to protect itself against the liability by showing that the actual purpose in inducing the accumulations was other than that penalized by the statute. It is submitted that no such result was intended under the statute, and that this Court should review the case and reverse the decision of the courts below thus based on an erroneous construction of the statute.

The second question of law referred to in the Government's brief in opposition to the petition for a writ of certiorari was whether the Tax Court had erred "by misapplying the presumption established by subdivision (b) of Section 102 of the Revenue Act of 1934." Subdivision (b) provides that "The fact * * * that the gains or profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to avoid surtax." It is clear under a proper construction of the statute that upon introduction of evidence as to the actual purposes inducing an accumulation, the effect of the accumulation as prima facie evidence of the existence of the condemned purpose disappears completely. See *Hemp-hill Schools, Inc. v. Commissioner*, 137 F. (2d) 961. The accumulations in the present case were fully explained by petitioner, but the Tax Court nevertheless gave weight to the artificial statutory presumption.

The Government contended in its brief in opposition to the petition for a writ of certiorari that the Tax Court based its decision in the alternative on a finding that "a preponderance of the evidence", without reference to the

statutory presumption, established the existence of the condemned purpose (pp. 15-16). However, the Tax Court's reference to the "preponderance of evidence" (R. 97) is misleading because the record presented no evidence to support the finding of the condemned purpose other than the accumulations beyond what the Tax Court deemed to be the reasonable needs of the business. (See pp. 31-33 and 38-43 of petition for writ of certiorari.)

In any event the Tax Court's misconstruction of the statute wholly vitiates its statement that its finding of the existence of the essential fact was based upon a "preponderance of the evidence," because it misapprehended what the essential fact was. The Court believed that the statute imposed liability unless the taxpayer proved a complete absence of the condemned purpose, whereas under a proper construction of the statute the condemned purpose must be a substantial factor in inducing the accumulation.

The decision below is of far-reaching importance and application, and involves questions of law which have not been, but should be, settled by this Court. The tax is applied for the first time to an active business corporation having hundreds of stockholders, paying large dividends, and making no loans to stockholders. The tax is imposed on the theory that it is necessary to do no more than infer that the condemned purpose was not completely lacking, and that this inference may be based merely on the conclusion of the Tax Court as to accumulation beyond reasonable business needs, with no affirmative evidence of the existence of the condemned purpose, and in the face of a full, reasonable and inherently probable explanation of the accumulation by the taxpayer. The result is to place every corporation in jeopardy of very heavy penalties in every

case where there is room for difference of opinion as to the reasonable present and future needs of the business. This is contrary both to the intention of the statute and the economic interests of the country, particularly in view of the present necessity that corporations retain adequate reserves with which to meet post-war problems of reconversion and reemployment.

Conclusion.

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that the judgment of the Circuit Court of Appeals be, upon further consideration, reversed.

Respectfully submitted,

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Certificate of Counsel.

We hereby certify that the foregoing petition is presented in good faith and not for delay.

ARTHUR A. BALLANTINE,
GEORGE E. CLEARY.